Trading for Development: Poor Countries Caveat Emptor

By

Jagdish Bhagwati

Jagdish Bhagwati is University Professor at Columbia University and Andre Meyer Senior Fellow in International Economics at the Council on Foreign Relations. He has been Economic Policy Adviser to the Director General, GATT, and Special Adviser to the UN on Globalization. He is currently an External Adviser to the Director General, WTO. He shared the Freedom Prize with Sir Leon Brittan. His latest book is Free Trade Today (Princeton).

The launch of a new Round of multilateral trade negotiations (MTN) at Doha dealt a needed blow to the anti-globalizers who had triumphed at Seattle just two years ago. But it was important for a different reason as well. The word "Development" now graces unconventionally the name of the new Round, alongside Doha. Development of the poor countries will be the central objective of the new Round.

But, pleasing rhetoric aside, we must ask: what <u>does</u> this mean? The question is not an idle one. For, if the current thinking in policy and NGO circles on what is the appropriate answer is any guide to what is in store for the poor countries, there is cause for alarm.

Of course, the proponents of trade have always considered that trade is the policy and development is the objective. The postwar experience only proves them right. The objections advanced by a handful of dissenting economists, claiming that free traders exaggerate the gains from trade or forget that good trade policy is best embedded within a package of reforms, mostly set up and knock down straw men, or aunt sallies, depending on your gender preference.

But if trade is indeed good for the poor countries, what can be done to enhance its value for them? A great deal. But not until we confront and discard several misconceptions that make for bad prescriptions. Among them:

- the world trading system is "unfair" : the poor countries face protectionism that is more acute than their own;

- the rich countries have wickedly held on to their trade barriers against poor countries while using the Bretton Woods institutions to force down the trade barriers of the poor countries; and
- it is "hypocritical" to ask poor countries to reduce their trade barriers when the rich countries have their own.

Asymmetry of Trade Barriers Goes the Other Way

Take industrial tariffs. As of today, the rich-country tariffs average 3 percent but 13 percent for the poor countries. Nor do peaks in tariffs, concentrated in textiles and garments, fisheries and footwear and clearly directed at the poor countries, change the picture much: UNCTAD has estimated that they apply to only a third of the poor-country exports. Moreover, the trade barriers of the poor countries are the more significant restraints faced by the poor countries than those imposed by the rich countries.

The situation is little different on the use of anti-dumping actions, the classic "fair trade" instrument that has ironically been used "unfairly" to undermine free trade. The "new" users, among them Argentina, Brazil, India, South Korea, South Africa and Mexico, are now filing more anti-dumping complaints than the rich countries. [Chart]. Between July and December 2001 alone, India carried out the largest number anywhere of anti-dumping investigations.

These facts fly in the face of the populist myth that the rich countries, often acting through the conditionality imposed by the World Bank and the International Monetary Fund, have demolished the trade barriers of the poor countries while holding on to their own trade barriers. Indeed, both the omnipotence of the Bretton Woods institutions, and the self-serving wickedness of the rich countries, have been grossly exaggerated, accounting for the allegations being the opposite of the true facts.

The World Bank's conditionality is so extensive and diffused, and its need to lend so compelling, that it can be bypassed: many client states typically satisfy some while ignoring other conditionalities. Besides, countries go to the IMF when there is a stabilization crisis. Since stabilization requires that the excess of expenditures over income be brought into line, the IMF has often been reluctant to suggest tariff reductions: they could reduce revenues, exacerbating the crisis.

Then again, since countries are free to return to their bad ways once the crisis is past, and the loans repaid, there can be reversals of the tariff reforms: unlike at the WTO, countries do not "bind" their tariff reductions at Bretton Woods. Equally, reversals in tariff reductions can occur when a stabilization crisis has recurred and the tariffs are re-imposed for revenue purposes. My student Ravi Yatawara, who has studied what he calls "commercial policy switches", documents several instances of such tariff reduction reversals by countries borrowing from the IMF. For instance, Uruguay in 1971 increased protection during an IMF program which began the year before and even managed to get another credit tranche the year after. Kenya's 1977 liberalization was reversed in 1979, the year that another arrangement was negotiated with the IMF.

Moreover, the comparatively higher trade barriers against the labour-intensive products are not the product of wickedness but are to be explained mostly by simple political economy. While unilateral reductions of trade barriers are not uncommon, and I document them for many countries and several sectors in the postwar period in my new book, <u>Going Alone: The Case for Relaxed Reciprocity in Freeing Trade</u> (MIT Press:

2002), the fact remains that the developing countries were exempted by the economic ideology of the time, which embraced Special and Differential (S&D) treatment for them, from having to make trade concessions of their own at the successive MTNs that reduced trade barriers in the postwar period. The rich countries, denied reciprocal concessions from the poor countries, wound up concentrating on liberalizing trade in products of interest largely to one another: e.g. machinery, chemicals, manufactures other than textiles and garments. If you want a free lunch, you do not get to eat at the Lord Mayor's banquet.

The situation changed when the poor countries became players. We then managed, in 1995 at Marrakesh where the Uruguay Round was concluded, to get at the infamous Multifibre Arrangement, which had grown from its birth in 1961 as the Short-term Cotton Textile Arrangement into a Frankenstein by 1974 when it brought under one umbrella several separate restrictive agreements restricting world trade in all textiles. MFA was put on the block, scheduled to terminate at the end of ten years.

But even if rich-country protectionism were asymmetrically higher, it would be dangerous to argue that it is then "hypocritical" to suggest to the poor countries to reduce their own trade barriers. Except in the few cases (hardly applicable to the poor countries) where strategic tit-for-tat play is credible, the net effect of matching others' protection with one's own is to hurt oneself twice over.

There is ample evidence that many leaders of the poor countries have predictably made the wrong inference: that rich-country hypocrisy excuses, and justifies, going easy on relaxing their own trade barriers. We should instead be saying to the rich countries something quite different: If you hold on to your own protection no matter how much smaller, and in fact even raise it as the United States did recently with steel and the Farm Bill, you are going to undermine seriously the efforts of the leaders in the poor countries who have turned to freer trade in recent decades. For, it is difficult to reduce protection if others, more prosperous and more fierce supporters of free trade, are breaking ranks.

Exports from the Poor Countries

In fact, the protectionism of the poor and the rich countries must be viewed together symbiotically to ensure effective exports by the poor countries. Thus, even if the doors to the markets of the rich countries were fully open to imports, the exports from the poor countries would have to get past their own doors.

We know from numerous case studies, dating back to the 1970s that only corroborated elementary economic logic, that one's own protection is often the cause of dismal export, and hence economic, performance. It creates a "bias against exports" by sheltering domestic markets that become then more lucrative. Just ask yourself why, even though India and the Far Eastern countries faced virtually the same external trade barriers, the inward-looking India registered a miserable export performance for a quarter of a century since the 1960s while the outward-looking South Korea, Taiwan, Singapore and Hong Kong chalked up spectacular exports. Charity begins at home; so do exports begin with a good domestic policy. In the near-exclusive focus on rich-country protectionism, this dramatic lesson has been perilously lost from view.

Effectively Assaulting Rich-country Protectionism

Yet, rich-country protectionism matters too; and it must be effectively assaulted. And we should be able to lend a strong helping hand, by countervailing the lobbying that makes it hard to make a dent, reinforcing the good work that reciprocal bargaining does. But here too, we witness folly.

The current fashion is to shame the rich countries by arguing that their protection hurts the poor countries whose poverty is the focus of renewed international efforts. And where action is actually undertaken, the preference is for granting preferences to the poorer countries, with yet deeper preferences to the poorest among them (the "Least Developed Countries" as they are now called) instead of giving MFN tariff reductions, and reducing subsidies in non-discriminatory fashion, in products of export interest to the poor countries. But the former solution is woefully inadequate; the latter is downright wrong.

If shame was sufficient, there would be no rich-country protectionism left: trade economists and international institutions such as the GATT and UNCTAD have denounced the rich countries on this count over three decades! Added support, such as that by today's "charities" such as Oxfam, could nonetheless help in principle. But these charities need both informed expertise and a talent for strategy and not just a conscience with a voice to do so. They fall short.

Regrettably, by subscribing to the counterproductive language of hypocrisy and the ill-advised resort to the rhetoric of "unfair trade" to attack protection by the rich when the phrase is a code word for protectionism today in the rich countries, a charity such as Oxfam, splendid at fighting plagues and famines, even does more harm than good in <u>our</u> good fight. One must remark that mission creep, even by non-creeps, can be an added problem rather than part of the solution

An effective strategy requires that we handle the labour-intensive goods such as textiles separately from agriculture. The differences between them dwarf the commonalities. The labour-intensive goods in the rich countries typically employ their own poor, the unskilled. To argue that we should eliminate protection, harming them simply because it helps yet poorer folks abroad, runs into evident ethical (and hence political) difficulties. The answer must be a gradual but certain, phase-out of the protection coupled with a <u>simultaneous</u> and substantial adjustment and retraining program. That way, we address the problems of the poor <u>both</u> at home and abroad.

Once this is done, one can ask the church groups and the charities to endorse this Balanced and just program. It is morally more compelling than either marching against free trade to protect the workers in the labour-intensive industries of the rich nations while forgetting the needs of the poor workers in the poor countries or asking for these trade restrictions to be abolished without providing for the workers in them in the rich countries.

The removal of agricultural protection does not raise similar ethical problems as when you hurt your poor workers: the production and export subsidies in the US and the EU go mainly to the <u>large</u> farmers. That should make it easier to assault it on grounds of helping the poor countries. At the same time, however, unlike textiles et al, agricultural protectionism is energetically defended on grounds of "multifunctionality": that agriculture has to do not just with production and trade but also with preservation of greenery and the environment. The greens are therefore in play and make protectionism more difficult to remove. But, just as income support can be de-linked from increasing production and exports, measures to support greenery also can be and such new measures, and other environmental protections added as sweeteners, must be part of the strategic assault on agricultural protection.

Drawing on the way that a target date such as Jubilee 2000 focused efforts on the objective of debt relief, I suggested well over a year ago, with a nod in its direction by UN Secretary General Kofi Annan, a Jubilee 2010 movement to eliminate protection on labour-intensive products by 2010. Since agricultural protection is politically a harder nut to crack, and will surely take more time, 2010 cannot be a realistic target date for its demise: 2020 is more realistic if we are serious. Both rich and poor nations' leaders need to endorse Jubilee 2010 therefore to terminate protection of labour-intensive goods and Jubilee 2020 for eliminating protection of agriculture. A start can be made at Johannesberg's mammoth UN Conference on "Sustainable Development" : a catchall phrase than can extend to any virtuous program.

Preferences: The Wrong Way

But a final word is necessary on the efforts to open the rich-country doors, not by reducing barriers on an MFN basis, but through grant of preferences to the poor countries. This approach goes back to the Generalized System of Preferences (GSP), introduced in 1971 through a waiver and then granted legal status in 1979 with the "Enabling Clause" at the GATT in 1979. The eligible poor countries were granted entry at preferentially lower tariff rates.

GSP did little for the poor countries. The eligible products often excluded products with significant export potential. Thus, the US GSP scheme excluded textiles and clothing, and footwear. Upper caps were also placed: the US imposed a $100 million limit on exports per tariff line, per year, per country; beyond this limit, the preferential rate terminated. Even the benefits granted were not "bound" and could be varied at the rich country's displeasure. Thus, when India was put on the Special 301 list in 1991 and the USTR determined unilaterally that India's intellectual property protection was "unreasonable", the President suspended duty-free privileges under GSP for $60 million in trade from India in April 1992.

GSP was often terminated on commodities and on countries when they began to be successfully exported: a fact documented in a forthcoming econometric study by Caglar Ozden and Eric Reinhardt. Rules of origin also served to moderate exports: exported items had to satisfy stringent local-content specifications to qualify as originating in the country before they could get GSP benefits.

By going down a similar preferential route in giving market access to the poor countries today, as with the US's Africa Growth and Opportunity Act (AGOA), or to only the poorest among them, as with the EU's "everything but arms"(EBE) initiative for eliminating trade barriers only for the 49 "Least Developed Countries", the rich countries are doing no better since virtually every drawback of GSP obtains in these schemes as well. If anything, these new schemes are doing worse. Thus, reverse preferences for US fabrics are built into the preferences for African garments exports to the US under AGOA.

It also sets off poor nations against other poor nations since preferences typically tend to lead to trade diversion away from non-preferred nations. It is also a wasting asset since the preferences are relative to the MFN tariff which will likely decline with further MTN liberalization. As such, and also because preferences given without bindings and can be withdrawn readily for political reasons, investors are not likely to respond.

Preferences sound attractive and generous and the poor countries have accepted them as such. But this has been a mistake. There is no good substitute for the MFN reduction of trade barriers in the rich countries. It should go hand in hand with enhanced technical and financial assistance preferentially focused on the poor nations so they can exploit the trade opportunities opened up non-preferentially.